No. 06-___

IN THE

Supreme Court of the United States

ROBERT M. SCHARRINGHAUSEN,
Defendant/Petitioner,

v.

UNITED STATED OF AMERICA,
Plaintiff/Respondent.

Appeal of Denial of Motion for Relief from Default Judgment to the United States Court of Appeals for the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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June 5, 2007

WILSON-EPES PRINTING CO., INC – (202) 789-0096 – WASHINGTON, D. C. 20002

QUESTIONS PRESENTED

1. Whether boilerplate allegations in a complaint that a taxpayer was a responsible person who willfully failed to pay over federal employment taxes are sufficiently certain to be taken as true upon default.

2. Whether a "presumption of correctness" arises as to Certificates of Assessment offered in support of a default judgment where the Department of Justice fails to introduce evidence of mailing at a default prove up hearing in District Court.

3. Whether a litigant's reliance on his attorney's advice to submit an offer in compromise to the IRS after being served a summons and complaint by the Department of Justice instead of filing a responsive pleading, is culpable conduct barring relief from a default judgment when the IRS receives the offer before the entry of default.

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OPINIONS BELOW

The opinion of the United States district court denying the defendant's motion for relief from default judgment appears at Appendix A and is unpublished.

The opinion of the United States district court granting the plaintiff's motion for entry of default judgment appears at Appendix B and is unpublished.

The opinion of the United States court of appeals denying defendant's appeal of the district Court's denial of the motion for relief from default judgment appears at Appendix C to the petition and is unpublished.

JURISDICTION

Jurisdiction of this Court is invoked under 28 U.S.C. §§ 1254(1). The district court had subject matter jurisdiction over the underlying action pursuant to 26 U.S.C. §§ 7402 and 28 U.S.C. §§ 1340 and 1345. The Ninth Circuit Court of Appeals had jurisdiction of the appeal under 28 U.S.C. § 1291.

On March 7, 2007, the United States Court of Appeals for the Ninth Circuit filed and entered judgment in this case. No petition for rehearing was filed.

STATEMENT OF THE CASE

The default judgment which the United States' secured in the amount of $488,307.96 against the petitioner, Robert M. Scharringhausen on November 3, 2004, reeks of prejudice.

Between 1980 and 2004, IRS transcripts for Mr. Scharringhausen show no tax liability except for income taxes in the amount of 1991 and 1992, which combined, came to $9,837.00 before interest and penalties, and for Trust Fund Recovery Penalties (TFRP) for unpaid federal employment taxes for the third and fourth quarters of 1990 for Scharringhausen Inc., and the second and third quarters of 1991 for Pantera Construction, Inc. The principal balance for 1990 was $145,579.46. The principal balance for 1991 was $56,469.89.

Although ostensibly irrelevant to the default judgment, the fact of Mr. Scharringhausen's 1996 conviction on three counts of bankruptcy fraud pervades these legal proceedings as does the 2002, IRS examination of Mr. Scharringhausen's 1999 and 2000, tax returns. According to the IRS, the 2002 investigation was prompted by the fact that Mr. Scharringhausen had a credit card issued from a bank in the Cayman Islands.

The IRS' "Offshore Credit Card Project" (OCCP), identified American taxpayers by name, and if associated with reputed "tax havens," investigations ensued. Despite the fact that millions of dollars were spent on this initiative, Pamela J. Gardiner, Acting Inspector General, for Tax Administration, testified before the U.S. Senate, Committee on Finance, on July 21, 2004, of the "mixed results" of the IRS' OCCP. According to Ms. Gardiner, the vast majority of the more than 3,000 completed cases were closed without an assessment of any additional taxes.

In late 2002, the IRS issued numerous third party summonses, again ostensibly relating to the determination of Mr. Scharringhausen's correct federal tax liabilities for the years 1999 and 2000.

Mr. Scharringhausen's attorney at the time, William J. Hartsock, moved to quash the summonses and in support of his opposition he filed a declaration with the Court in the USDC Case No. 02-CV-02076. Mr. Hartsock stated that in his meeting with IRS revenue agent, Huong Phan on September 26, 2002, Ms. Phan referred to Mr. Scharringhausen's conviction, "badges of fraud" and that her feeling was the audit "may go criminal."

The DOJ assigned attorney Norma Schrock, a trial attorney for the Tax Division to quash the summonses. The summonses' were quashed and some two months later, on March 20, 2003, Ms. Schrock filed the complaint to reduce federal tax assessments to judgment, USDC Case No.03CV0551-K-RBB, which is the subject of this appeal.

On or about April 9, 2003, prior to the date the government served the complaint on Mr. Scharringhausen, Attorney David Greenberg requested tax information for the years which are the subject of the complaint.

On April 11, 2003, the DOJ served the summons and complaint on Mr. Scharringhausen and he forwarded these to Mr. Greenberg.

On or about May 5, 2003, attorney David Greenberg informed the IRS he was going to be representing Mr. Scharringhausen regarding all tax matters relating to the tax years 1990-2004, for personal income taxes and for the years ending 12/31/90 and 09/30/91 for Trust Fund Recovery Penalties.

The IRS responded to Mr. Greenberg in a letter dated May 8, 2003, and received notice that Mr. Greenberg was representing Mr. Scharringhausen five days before any responsive pleading to the complaint had to be filed and almost two months before the Department of Justice (DOJ) filed the Request for Entry of Default on July 3, 2004.[1]

Although he was aware that Mr. Scharringhausen was concerned about the lawsuit, Mr. Greenberg, told Mr. Scharringhausen that there was nothing he could do, that the money the government alleged in the complaint that Mr. Scharringhausen owed could be included in an offer in compromise and that the lawsuit was the IRS' way of being able to continue to try to collect the amounts allegedly owed.

On May 15, 2003, Mr. Scharringhausen provided Mr. Greenberg with a draft of an Offer in Compromise (the Offer) and on or about May 19, 2003, Mr. Scharringhausen mailed the Offer and included the amounts alleged to be owed in the complaint, as well as the tax years 1997, 1998.

On or about June 4, 2003, the IRS erroneously returned the Offer to Mr. Scharringhausen stating that their records showed he had not filed returns for 1997 and 1998.

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[1] Mr. Greenberg is listed on Civil Case Docket Sheet as an attorney for Mr. Scharringhausen, in USDC 03-CV-0551-K-RBB but was never served any pleadings by the Department of Justice.

On or about June 12, 2003, Mr. Scharringhausen responded to the IRS that in fact he had provided them everything they needed in his initial Offer.

On or about July 1, 2003, the IRS acknowledged receipt of the Offer again with a letter to Mr. Greenberg and Mr. Scharringhausen.

On July 3, 2003, Norma Schrock, who admitted to having "certain" administrative files of the IRS on Mr. Scharringhausen moved to request an entry of a default against Mr. Scharringhausen on the same tax matters that were the subject of the Offer.

On July 7, 2003, Mr. Scharringhausen returned a copy of the July 1, 2003, IRS letter to the IRS. He did not hear from the IRS again until September 16, 2003, when the IRS indicated that "*other investigations are pending that may affect the liability sought to be compromised or the grounds upon which it was submitted*"[2]

In an order dated September 23, 2003, the District Court denied the government's motion for entry of default judgment because the government failed to provide sufficient documentation of the damages. In fact, the Certificates of Assessment which the government submitted in support of its first motion fc default judgment were for tax years 1988, 1989, and 1990 for individual income.

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[2] In *Federal Tax Collections, Liens, and Levies*, by William D. Elliott, 2d Ed., 2004 Cum. Sup. No. 2, page S-22-41 ¶ 22,08, the author notes in relation to an Offer in Compromise where a referral is made to the IRS' Criminal Investigation unit, and a "criminal case is accepted, the examining officer is instructed to not contact the taxpayer regarding the status of the offer until after Criminal Investigation has informed the taxpayer of the fraud investigation. After this has been done, the taxpayer should be informed that: 1. The offer will be rejected because *other investigations are pending that may affect either the liability sought to be compromised or the grounds on which it was submitted* or . . ."

This is interesting only because Mr. Scharringhausen later discovered through a Freedom of Information Act Request that the DOJ knew at the time it filed the complaint, in March 2003, but failed to ever inform any Court, that it had no administrative file from the IRS on which to base its allegations for the TFRP for 1990, because they had been destroyed.

On or about October 10, 2003, the government notified Mr. Scharringhausen that they were moving to enter default judgment for a second time. Mr. Scharringhausen forwarded this pleading as he had done with the summons and complaint to Mr. Greenberg.

On or about December 3, 2003, the government mailed post-judgment discovery which Mr. Scharringhausen forwarded with responses to David Greenberg.

In March 2004, the government notified Mr. Scharringhausen that it was seeking to compel responses to the post-judgment discovery and asking for an award of costs at a hearing set for April 10, 2004, which was continued until April 19, 2004.

Following receipt of the government's motion Mr. Scharringhausen contacted another attorney, Ezekiel Cortez as Mr. Greenberg indicated he was not going to appear at the April 19, 2004, hearing.

At the April 19, 2004, hearing Mr. Cortez, specially appeared for Mr. Scharringhausen before the magistrate and explained that he was appearing because:

> MR. CORTEZ: . . . I represented Mr. Scharringhausen years ago in a federal prosecution where he was acquitted, partly. And late, arising from a separate IRS inquiry, there were issues regarding whether there was a fraud investigation afoot, and whether he could be the subject of yet another indictment.

Mr. Cortez, went on to explain:

> Without violating attorney/client privilege, I can tell you that when I first encountered this issue, he was lost. I guess he didn't have a clear direction as to what was happening. The Fifth Amendment issue has surfaced within the past two and a half weeks, so it hasn't been an issue that's been there lingering and no one looked at it and decided to a waive it by default. In fact, the Fifth Amendment issue wasn't even perceived by Mr. Greenberg, because that's not his speciality. I saw it instantly regarding some recent developments.

On July 9, 2004, Mr. Scharringhausen served responses to the government's December, 2003, post judgment interrogatories and requests for production of documents and asserted the Fifth Amendment to most of the requests.

By October 2004, a hearing was held where the Magistrate denied the government motion for an order holding the Fifth Amendment had been waived, upheld the Fifth Amendment to some requests and granted the government's motion to compel the production of documents and responses to interrogatories to remaining requests.

Mr. Scharringhausen timely filed a motion for relief with a new judge as Judge Judith Keep, who had been assigned to the case and had granted the motion for entry of default and the default judgment, had passed away.

On January 5, 2005, the Court denied Mr. Scharringhausen's motion for relief stating Mr. Scharringhausen's culpable conduct had lead to the default, that he failed to assert a meritorious defense and that the government would be prejudiced by reopening the action.

Mr. Scharringhausen filed a timely appeal to the United States Court of Appeal for the Ninth Circuit. On March 7, 2007, the Court of Appeal found that the denial of the Rule 60(b) motion was not an abuse of discretion.

REASONS FOR GRANTING THE PETITION

In 1996, Congress amended section 26 U.S.C. § 6672 to require the agency to issue a preliminary notice to the taxpayer before imposing an assessment. (See Taxpayer Bill of Rights 2, Pub. L. No. 104-168, 901(a), 110 Stat. 1452, 1465 (1996) (codifying notice requirement at 26 U.S.C. 6672 (b)). In testimony before Congress, Nina Olson, the National Taxpayer Advocate, noted that "institutional tendencies" of the IRS prior to 1998 and lingering today, can lead to a "death by a thousand cuts" and "pendulum swings," whereby the public comes to perceive the IRS as caring "more about enforcement results than about helping taxpayers become or remain in compliance with tax laws." (See The National Taxpayer Advocate's (NTA) Fiscal Year 2005 Objectives Report to Congress, pages 1 and 2).

The NTA also reported to Congress that "The IRS has had difficulty in administering this program since its inception. This is due in part, to the Service's underlying uneasiness about permitting a taxpayer to be relieved of a legally due tax." (NTA 2005 Report page 7) and citing "A 2003 IRS focus group which found that *'virtually all the practitioners believe that the Offer in Compromise program is not working.*" (NTA 2005 Report, page 8, footnotes 12 and 13) (Emphasis Added).

Putting aside the fact that Mr. Scharringhausen discovered through the Freedom of Information Act subsequent to filing his appeal with the Ninth Circuit that the DOJ knew several months before it ever filed the complaint in March 2003, that they had no administrative file for the year 1990 because it had been destroyed, and putting aside the fact that the DOJ submitted declarations to the District Court which stated that it had reviewed administrative files when no such documents existed for 1990, and putting aside the fact that the DOJ stated in its declarations to the Court that Mr. Scharringhausen was liable for the TFRP and interest, when it was held

in *Williams v. United States*, 939 F.2d 915, 916 (1991), that "under §§ 6672, responsible persons may be liable for a 100 percent penalty for withholding taxes not paid by their corporation, but not for penalties *and interest assessed against the corporation for failure to pay withholding tax*," (Emphasis Added), the problem with the way this default judgment was secured is the facade of legal propriety and lip service given to the principles of law and equity.

Set against the backdrop of the facts and circumstances leading up to the filing of the complaint and with nothing more than boilerplate allegations stated in the complaint the DOJ created the illusion that it had a well plead complaint, supported by Certificates of Assessment (4340's) and declarations in a proper format.

However, the reality is that the boilerplate wording in the complaint referring to Mr. Scharringhausen as being a "willful" and "responsible" person liable for the TFRP and the 4340's are insufficient to sustain the default judgment.

1. The Complaint is not Well Plead

The question of whether a default judgment is fair relates to the sufficiency of the allegations in the complaint. As the Supreme Court stated in what is referred to as the "venerable but still definitive case" of *Thomson v. Wooster*, 114 U.S. 104 (1884), "a default judgment may be lawfully entered only 'according to what is proper to be decreed upon the statements of the bill, assumed to be true,' and not "as of course according to the prayer of the bill.'" *Nishimatsu Construction Co. v. Houston National Bank*, 515 F.2d 1200 (5th Cir. 1975).

While the general rule cited in support of a default judgment is that the entry of default functions as an admission of the plaintiff's well pleaded allegations of fact, *Daning v. Lavine*, 572 F.2d 1386 (9th Cir. 1986), questions remain. What is well pleaded? What is proper to be decreed? What

is an allegation of fact? In *Ohio C. R. Co. v. Central Trust Co.*, 133 U.S. 83, 91 (1890) this Court addressed that issue:

> If the allegations are distinct and positive, they may be taken as true without proof; but if they are indefinite, or the demand of the complainant is in its nature uncertain, the requisite certainty must be afforded by proof. But in either event, although the defendant may not be allowed, on appeal, to question the want of testimony or the insufficiency or amount of the evidence, he is not precluded from contesting the sufficiency of the bill, or from insisting that the averments contained in it do not justify the decree.

In *Clifton v. Tomb*, 21 F.2d 893, 897 (1927) the Court further explained that:

> A bill pro confesso, when confessed by the default of the defendant, is taken to be true in all matters *alleged with sufficient certainty*; but in respect to matters not alleged with due certainty, or subjects which from their nature and the course of the court require an examination of details, the obligation to furnish proofs rests on the complainant. Thomson v. Wooster, 114 U.S. 104 (1884) *in respect to matters not alleged with due certainty, or subjects which from their nature require an examination in detail, the obligation to furnish proofs rests on the complainant.* (Emphasis Added).

In the dissenting opinion, in *Artesia Ready Mix Concrete, Inc.*, 339 N.L.R.B. 1224, 1228-29 (2003) (dissenting opinion Schaumber) it was noted that the requirement of having "well pleaded", allegations is not an "archaic holdover[ ]from the common law or legal niceties that can be dispensed with when it is convenient to do so:"

> While '[a] default judgment is unassailable on the merits, [it is so] ***only so far as it is supported*** (emphasis added) by *well pleaded* allegations assumed to be true.', (emphasis in original). Conversely, claims that are not well pleaded cannot support a default judgment. (internal

> citations omitted). [T]he Supreme Court and the lower federal courts have consistently held that "the binding character of the decree . . . renders it proper that this degree of precaution be taken."

"On appeal, the defendant, although he may not challenge the sufficiency of the evidence, is entitled to contest the sufficiency of the complaint and its allegations to support the judgment." *Artesia* at 1228-29 citing *Nishimatsu*, *Ohio C. R. Co.*, and *Thomson*.

Here, the boilerplate language in the complaint alleging that Mr. Scharringhausen "was responsible for collecting taxes" and that he "willfully failed to collect" and pay the United States for 1990 and 1991 fall short. An initial question is do these statements pass as "distinct and positive," so that they may be taken as true without proof?

2. Circuit's Are Split on the Element of "Responsibility" under 26 U.S.C. §6672

Under federal law there is a split in the circuits as to when a person is considered "responsible," for purposes of the requirements of 26 U.S.C. § 6672. In *Bradshaw v. United States*, 83 F.3d 1175, 1178 (1995), the government argued that whether a person was or was not a responsible person is a question of law. The 10th Circuit resolved this in *Taylor v. Internal Revenue Service*, 69 F.3d 411 (1995) (10th Cir. slip op. at 7), where the Court held "that the ultimate determination whether an individual is a 'responsible person' within the meaning of 26 U.S.C. 6672 involves an application of law to fact which is subject to *de novo* review on appeal."

The *Taylor* court noted that this holding "agreed with the views of the Second and Eleventh Circuits, but that the First, Fifth, Sixth, Seventh, and Ninth Circuits "treat the issue of responsibility under 6672 as a question of fact and apply the clearly erroneous standard of review." (Citations omitted). This split results in an unfair application of the TFRP because

some circuits find the question as one of mixed law and fact while others simply accept it as a question of fact. The result of this unfairness is that in circumstances such as this, if the Court believes a boilerplate allegation that one is "responsible" for TFRP is deemed to be true, then there is no need for any proof of this element at a prove up hearing on the request for entry of default judgment. However, in circuits where the question is one of an application of law to the facts, the boilerplate reference would be insufficient and require the DOJ to either allege specific facts in a complaint or establish at a prove up hearing the factual basis for the allegation, such as the documentation that is supposed to exist in the IRS administrative files. Indeed, the Internal Revenue Manual, Part 5, Chapter 7, Section 6, subsection 5.7.6.5, notes that "Adequate supporting documentation must be contained in the file(s) to fully support all recommendations for assertion."

Even assuming it is a question of fact this complaint does not meet the requirement of well pleaded allegations because the complaint is simply boilerplate and fails to allege what the IRS did in its administrative process, according to its procedures, to reach the conclusion of fact as to responsibility. Otherwise the matter of responsibility simply is not alleged with the requisite "due certainty." In fact, a default judgment for taxes in the amount of almost a half a million dollars has to be a subject which requires an examination in detail because the District Court required the government to show how it determined the amounts it alleged Mr. Scharringhausen owed. Had the District Court been informed that the DOJ had no administrative file for 1990 and therefore no supporting documentation for the assertion that Mr. Scharringhausen was found by the IRS to be the person responsible for paying the federal employment taxes, clearly the outcome would have been different.

3. "Willfulness" under 6672 must Be Established by Circumstantial Evidence

As for the allegation on the element of "willfulness" under the 6672, although an undisputed question of fact when well plead the question is whether simply alleging one is "willful" is "well plead." Under Wooster the boilerplate allegation that Mr. Scharringhausen was "willful" in failing to pay the federal employment taxes is assailable on the merits because this conclusory statement is not supported by any facts in the complaint. Therefore, it is not assumed to be true on default. In particular the allegation that one was "willful" in not paying the federal employment tax is insufficient pleading because "willfulness" is not "generally amenable to direct proof and must be shown by *circumstantial evidence*." *Wilson v. United States*, 250 F.2d 312, 325 (1957). (Emphasis Added).

Here, the complaint failed to allege the essential facts of willfulness with"due certainty," as there was no showing by the government at a prove up hearing of any circumstantial evidence, again what should have been in the IRS administrative file, to establish Mr. Scharringhausen "willfully" failed to pay taxes, even if he was responsible.

The complaint is not well plead as to this element because it does not allege that the IRS followed its procedures, conducted interviews, or documented any facts to reach the conclusion that Mr. Scharringhausen was "willful" in not paying taxes.

Having failed to take the precaution at the default prove up hearing to require the DOJ to present support for the allegations of willful and responsible, the District Court entered judgment against Mr. Scharringhausen on a complaint that did not allege with due certainty the grounds for liability and the subject of this complaint, a large monetary sum, requires by its nature an examination in detail, especially in light of

the fact that the agency alleging the deficiency has a history of taxpayer abuse and it came to light after the fact, that the IRS did not even have an administrative file for 1990, and never disclosed this to the Court.

4. The Government Made a Naked Assessment

"In an action to collect a tax, the government bears the initial burden of proof. The assessment of tax ordinarily establishes the government's prima facie case, so it becomes incumbent on the taxpayer to establish an issue of fact." *Jones v. United States*, 60 F.3d 584, 589 (1995). Although 4340's are usually considered prima facie evidence of the assessment:

> [w]here the official certificates do not support the proposition which must be proved, however, and lend themselves to an inference that the proposition is false, then the existence of official certificates does not suffice for summary judgment. One must read the official documents to see what they say. It is insufficient merely that they exist. *Jones* at 590.

Moreover, under 26 USC section 7491(c) "Notwithstanding any other provision of this title, the Secretary shall have the burden of production in any court proceeding with respect to the liability of any individual for any penalty . . ." Here the government secured the judgment against Mr. Scharringhausen without ever having introduced a single shred of substantive evidence, and had they been put to the test, it would have come to light that they had no evidence whatsoever from the administrative file of the IRS for 1990.

The cornerstone of the government's case and the basis ultimately for the Court granting the motion to enter a default judgment rested on declarations of the government and Certificates of Assessment (4340's). Under *United States v. Janis*, 428 U.S. 433, 440-41, (1933) assessments are, "when properly certified, . . . presumptively correct evidence of a

taxpayer's liability and satisfies the government's burden of proof." But this "presumption" did not arise, nor can it be relied on to establish that a person is "willful" and "responsible" under 26 U.S.C. § 6672 to prove liability for a penalty without a factual foundation. ("a presumption of correctness attaches to the Commissioner's assessments for unpaid taxes so long as they are 'supported by a minimal factual foundation,'" *Palmer v. United States Revenue Service*, 116 F.3d 1309, 1312 (9th Cir. 1997).

The factual foundation for the assessment is laid "once some substantive evidence is introduced demonstrating that the taxpayer received unreported income." *Edwards v. Commissioner*, 680 F.2d 1268, 1270 (9th Cir. 1982) (per curiam).

In *Weimerskirch v. Commissioner*, 596 F.2d 358, 361062 (9th Cir. 1979) the government assessed deficiencies against an individual based on the allegation that he had unreported income from the sale of drugs. However, "[t]he government offered no evidence, . . . showing that Weimerskirch had ever sold any heroin, or that he had received any unreported income. As a result, in *Weimerskirch* the government could not simply rely on the "presumption of correctness."

Here, not only was there no factual foundation laid out in the complaint alleging why it was that Mr. Scharringhausen was a willful and responsible person responsible for almost a half a million dollars in penalties and interest, but the 4340's did not establish that notice and demand had in fact been sent and made.

For a clear example of the illusion created by the DOJ, the Court will only need to look at the declaration of DOJ attorney Norma Schrock in support of the United States' Motion for Default Judgment. Schrock states that "The Certificates of Assessments and Payments offered by the United States in conjunction with this motion are . . . the proper means of establishing the facts of the administrative

assessment, and notice and demand for payment." Ms. Schrock cites the District Court in stylized fashion, to *"Hansen v. United States*, 7 F.3d 137, 138 (9th Cir. 1993) (Form 4340's are proof that proper notices were sent); *Hughes v. United States*, 953 F.2d 531, 539-40 (9th Cir. 1991)."

Review of *Hansen* and *Hughes* on this point of law however show they rely on *United States v. Zolla*, 724 F.2d 808, 809 (1984). Zolla adopted the view of the Court in *United States v. Ahrens*, 530 F.2d 781, 784-86 (8th Cir. 1976) which stated that as to this particular point of law, notice and demand, the IRS meets its burden and gains the benefit of a presumption not by simply offering 4340's but when:

> The government submitted *postal form 3877* certifying that the notices of deficiency *had been mailed* and an IRS form certifying that the taxes and the section 6651(a)(3) 1 failure-to-pay penalties had been assessed. Zolla offered no contrary evidence. (Emphasis Added).

In *Zolla*, at 809, the Court explained *when* a "presumption of correctness" arises:

> This court has held that no *presumption of correctness* attaches to deficiency determinations in which the IRS charges a taxpayer with additional income but provides no factual showing that the taxpayer actually received the income in question. To give effect to the presumption in such circumstances would impose on the taxpayer the difficult task of proving a negative.

Here, there was no *presumption of correctness* that the penalties to be paid by Mr. Scharringhausen, were his burden simply by the fact that the District Court accepted the 4340's. Having failed to allege in the complaint that it had in fact proof of the mailing in the form of the 3877, the complaint was deficient.

That this would be required on the default prove up is again evidenced by the fact that the District Court required

the DOJ to submit the 4340's. If it was important for the Court to be shown evidence at the prove up of the accrual of interest and penalties, it would be equally important for the Court to have proof that the notice and demand was sent. The DOJ did not point out to the Court that the 4340's do not establish the fact of notice and mailing and the Court simply accepted the 4340's as proof of deficiency being assessed and for the fact that notice and demand had been made.

To give effect to the presumption of correctness in the circumstances of a default judgment and not require the government to produce Form 3877 certifying that the notices of deficiency *had been mailed*, the District Court, gave the government a default judgment on a complaint that was not well plead. The default judgment in this case is devoid of any foundation as to willfulness and responsibility for the TFRP and devoid of any foundation as to the actual mailing of notice. Therefore Mr. Scharringhausen did raise a meritorious defenses.

5. The Circuits Are Split on "Culpability" in the Context of a Rule 60(b) Motion

As Justice O'Connor stated in her dissent in *Pioneer Inv. Serv. Co. v. Brunswick Assocs. P'ship*, 507 U.S. 380, 403 (1993), joined by Justices, Scalia, Souter and Thomas "it is quite unnatural to read the term 'excusable neglect' to mean a variety of neglect that, in light of *subsequent* events *and* all the equities, *turns out to be excusable*." (Emphasis Added). Justice O'Connor points out that the circularity of this approach and that "excusable neglect becomes the neglect that the court in its equitable discretion chooses to excuse." Following *Pioneer*, the Courts have been in disarray over the concept of excusable neglect and Justice O'Connor's observation was prescient.

Even after the Supreme Court addressed the concept of "excusable neglect" in *Pioneer* where it was stated that "at

least for purposes of Rule 60(b), 'excusable neglect' is understood to encompass situations in which the failure to comply with a filing deadline is attributable to negligence," the Court of Appeal for the Sixth Circuit in *American Alliance Ins. Co. v. Eagle Ins. Co.*, 92 F.3d 57, 60 (1996), set out the split amongst the Circuit Courts as to the meaning of "willful" as it relates to the consideration of "culpability" and "excusable neglect," in the context of a Rule 60(b) motion.

The Third Circuit has held that a Rule 60(b)(1) motion to vacate will be denied only on a showing of "culpable conduct," defined as "actions taken willfully or in bad faith." *Gross v. Stereo Component Systems, Inc.*, 700 F.2d 120, 123-24 (3d Cir. 1983), (requiring more than the "gross—*almost* willful neglect" (Emphasis in Original).

The Sixth Circuit followed the Third in requiring some showing of "culpable conduct *United Coin Meter Co., Inc. v. Seaboard Coastline Railroad*, 705 F.2d 839, 844-45 (6th Cir. 1983). (Declining to define that phrase precisely, but stating in *Shepard Claims Service, Inc. v. William Darrah & Associates*, 796 F.2d 190, 195 (6th Cir. 1986) that "to be treated as culpable, the conduct of a defendant must display either an intent to thwart judicial proceedings or a reckless disregard for the effect of its conduct on those proceedings."Id. at 194).

American Alliance noted that other circuits "in contrast, expressly refuse to vacate default judgments occurring as a result of attorney carelessness." (Citing *Johnson v. Gudmundsson*, 35 F.3d 1104, 1117 (7th Cir. 1994) (Relief from default will only be granted "where the actions leading to the default were not willful, careless, or negligent."); *CJC Holdings, Inc. v. Wright & Lato, Inc.*, 979 F.2d 60, 64 (5th Cir. 1992) (focus on "neglect or culpable conduct . . . more consistent with rule 60(b)" than focus on "willfulness"); *Davis v. Safeway Stores, Inc.*, 532 F.2d 489, 490 (5th Cir. 1976) (per curiam) (failure of insurance company to communicate with defendant three weeks after receiving copy of

complaint suggests "absence of minimal internal procedural safeguards" and is not excusable neglect); *Baez v. S.S. Kresge Co.*, 518 F.2d 349, 350 (5th Cir. 1975) (delay due to numerous forwardings not excusable neglect), *Gibbs v. Air Canada*, 810 F.2d 1529, 1537-38 (11th Cir. 1987) (misplacement of complaint by mail clerk not excusable neglect); *Pelican Production Corp. v. Marino*, 893 F.2d 1143, 1146 (10th Cir. 1990) ("carelessness by a litigant or his counsel does not afford a basis for relief under Rule 60(b)(1)," albeit in a case in which the party failed to provide any explanation for its previous lawyer's failure to answer the motion to dismiss.).

The Ninth Circuit defines "culpable conduct" for Rule 60(b) purposes "as conduct for which there is no explanation of default inconsistent with a devious, deliberate, willful, or bad faith failure to respond."

This wide discrepancy in defining what is "excusable" and by extension "culpable" conduct makes no sense, especially in light of the policy considerations which though lofty sounding and often cited, seldom, if ever carry the day. Though lip service is paid by the Ninth Circuit, to the "important policy considerations," that are to guide a district court judge's discretion on a Rule 60(b) motion, (*Schwab v. Bullock's, Inc.*, 508 F.2d 353 (1974) (motion to vacate a default judgment remedial in nature and therefore must be *liberally applied*; default judgments are *generally disfavored*; *whenever* it is reasonably possible, *cases should be decided on their merits*; "where timely relief is sought from a default judgment and the movant has a meritorious defense, *doubt, if any*, should be resolved in favor of the motion to set aside the judgment so that cases may be decided on their merits"); ("this Court has emphasized that such judgments are '*appropriate only in extreme circumstances*; a case should, whenever possible, be decided on the merits'" *TCI Group Life Ins. Plan v. Knoebber*, 244 F.3d 691, 696 (2001)).

In this case, Mr. Scharringhausen produced two declarations from his attorney Mr. Greenberg explaining the reasons that lead to the default judgment. The District Court ignored them. Mr. Scharringhausen also submitted a declaration explaining the circumstances leading up to the default. This was ignored as well. Mr. Scharringhausen pointed out the facts and circumstances surrounding the case at the time which raised the question of Fifth Amendment issues, that he *had* forwarded all pleadings and discovery to Mr. Greenberg, *and* that he had submitted an Offer to the IRS. Nevertheless, the District Court concluded that "Defendant's actions throughout this litigation demonstrate that his failure to answer is not excused by a credible, good faith explanation."

The District Court also concluded that Mr. Scharringhausen was culpable because by the time he had submitted the offer, May 19, 2003, he had already defaulted. This is incorrect because the Request for Entry of default was not made by the government until July 3, 2003, which was 52 days after the government could have filed a request for entry of default.

In a seeming "catch-all" for why the District Court found that Mr. Scharringhausen's failure to bring the motion for relief until eleven months after it was entered was further evidence of bad faith, the District Court concluded that Mr. Scharringhausen had exhibited a lack of diligence. However, the record shows that Mr. Scharringhausen was not aware of the extent of the misunderstanding between himself and Mr. Greenberg until April 2004.

In fact the record in this case does not show Mr. Scharringhausen as dilatory. The default judgment resulted from a mistake and the explanations offered were disregarded by the District Court with circular logic and reference to Mr. Scharringhausen's prior litigation. The district court concluded the neglect that lead to the default was inexcusable because it was inexcusable!

Despite the fact that there was an explanation for the failure to respond to a complaint, the District Court dismissed it after the fact. Mr. Scharringhausen was told that there was nothing he could do in response to the complaint. Had Mr. Greenberg told him he had to file an answer there is nothing in the record to suggest he would not have filed an answer. The explanation for the default is clearly inconsistent with a devious, deliberate, willful or bad faith failure to respond.

Despite the fact that Mr. Scharringhausen presented an explanation for why the complaint went unanswered the District Court concluded that Mr. Scharringhausen's claim that he would have appeared to oppose the default judgment motion if he had proper notice of the second hearing, "specious when he failed to respond to the complaint, the request for entry of default, the government's first default judgment motion, or the government's post-judgment discovery requests."

Neither the record nor the law support the district Court's conclusion. On a Rule 60(b) motion the Court is *required* to "accept as true the movant's factual allegations." *Cassidy v. Tenorio* 856 F.2d 1412 (9th Cir 1988) (Citing *Falk v. Allen* 739 F.2d 461, 464 (9th Cir. 1984) (Per Curiam)). Deciding that the explanation was specious means that the factual allegations were not accepted as true.

The District Court needed to look no further than the declaration of Mr. Greenberg for a credible explanation for why the default occurred.

> I declare that, had Scharringhausen not have misunderstood my advice, he would have answered all pleadings, correspondence and communications from Attorney Schrock without hesitation because that has been his wish all along—to answer all allegations made against him. . . . he is a fighter and would not simply ignore a legal process.

The conflict amongst the circuits is also shown by *Pelican Production Corp. v. Marino*, 893 F.2d 1143. 1147 where the 10th Circuit stated that where a party claims his attorney was in error, "We believe a most obvious void exists where a party claims that its counsel's activities were not its own, but fails to demonstrate to the court any effort to produce explanation from its former counsel for his conduct." Having done exactly what the court in the Tenth Circuit advised, it was useless in the Ninth Circuit.

CONCLUSION

It bears repeating that the IRS has a history of taxpayer abuse and documented "institutional tendencies" which linger today that can lead to a "death by a thousand cuts" when the focus of tax administration is more on enforcement than in helping taxpayers become or remain in compliance with tax laws.

Here, the IRS received an Offer in Compromise from a taxpayer, who although convicted of bankruptcy fraud in 1996 has been attempting to utilize the avenues available to every taxpayer to resolve tax disputes to no avail. Despite evidence explaining the reasons why an answer to the complaint had not been filed, neither the District Court, nor the Court of Appeal, reviewed the law or the facts of this case, in part it appears because of the nature of the legal factors adopted by the Ninth Circuit.

Circular logic in the analysis of "excusable neglect" shows that Courts are taking widely divergent views of what constitutes grounds for relief, despite the Supreme Court's decision in *Pioneer Inv. Serv. Co. v. Brunswick Assocs. P'ship*, 507 U.S. 380, 403 (1993).

Over the course of several months the IRS never told the taxpayer to contact the DOJ about any offer to settle. Rather the IRS sat on the offer until after a default had been entered

and returned it with nothing more than a form letter indicating that "other investigations were pending."

Only through a Freedom of Information Act request, after an appeal to the Ninth Circuit had been filed did it come to light that neither the IRS, nor the DOJ had any evidence to support any of the allegations, at least as to one of the tax years that were the subject of the complaint and almost half of the $488,307.96, default judgment.

In a prove up hearing on the default judgment the District Court failed to required the DOJ to provide the foundation for the claimed assessments and failed to require proof that notice and demand for payment had been made. The court also failed to require the DOJ present the foundation for the claim that the taxpayer was in fact a "responsible" person who 'willfully" failed to pay over federal employment taxes.

Despite the fact that the taxpayer provided an explanation, and legal and factual grounds in support for his motion to set aside the default judgment both the Court of Appeal upheld the granting of the default judgment, which it is said should only be granted in "extreme circumstances." Clearly there is a disjunction between the facts and the law as shown in this case and other circuits where "willfulness" is determined by varying and circular degrees of logic.

Based of all of the preceding, Petitioner respectfully submits that the petition for a writ of certiorari should be granted.

Respectfully submitted,

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June 5, 2007